

## Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 SS-15 NSC-05 INR-07 CIAE-00 PM-04

DODE-00 L-03 SP-02 TRSE-00 EB-07 OMB-01 /059 W

-----102153Z 025924 /64L

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FM AMEMBASSY PANAMA

TO SECSTATE WASHDC 2309

INFO AMEMBASSY GUATEMALA

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FOR: ROCAP GUATEMALA

E.O. 11652: N/A

TAGS: ECON, EFIN, PN

SUBJECT: PANAMA'S RECESSION CONTINUES

REF: (A) PANAMA 4094, (B) PANAMA 0975, (C) PANAMA 8521

(12/17/76)

1. SUMMARY: ECONOMIC ACTIVITY IN PANAMA DURING THE 1977 FIRST QUARTER WAS LITTLL CHANGED FROM ITS DEPRESSED 1976 PACE, WHEN GROSS DOMESTIC PRODUCT FAILED TO INCREASE, IN REAL TERMS, ABOVE THE LEVEL OF 1975. FINANCIAL PRESSURES FORCED HE GOP TO ADOPT HIGHLY RESTRICTIVE FISCAL MEASURES FOR 1977, VIZ., A 5 PERCENT VALUE ADDED TAX, AND PUBLIC SECTOR CREDIT AND EXPENDITURE CURBS. THESE FISCAL CONSTRAINTS WILL HAVE A DEPRESSING EFFECT ON EMPLOYMENT AND INCOME, AND TOGETHER WITH CONTINUING LACK OF GROWTH IN PRIVATE INVESTMENT WILL PROBABLY FORESTALL ANY GENERAL ECONOMIC EXPANSION AGAIN THIS YEAR. END SUMMARY.

2. ECONOMIC INDICATORS SHOW NEITHER IMPROVEMENT NOR WORSENING OF THE PANAMANIAN RECESSION THROUGH THE FIRST QUARTER OF 1977. PRELIMINARY FIRST QUARTER DATA SHOW INDUSTRIAL PRODUCTION AT APPROXIMATELY ITS 1976 LEVEL. NEW CONSTRUCTION PERMITS WERE

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BELOW THE DEPRESSED LEVEL OF A YEAR AGO. CREDIT TO THE PRIVATE SECTOR WAS LITTLE CHANGED. AGRICULTURAL OUTPUT CONTINUED TO SUFFER FROM THE DROUGHT WHICH WAS NOT BROKEN UNTIL MAY. THE VALUE OF PANAMA'S EXPORTS (EXCLUDING PETROLEUM) REMAINED NEAR YEAR AGO LEVELS, WITH HIGHER VOLUME OF SUGAR EXPORTS OFFSET BY THE LOW WORLD SUGAR PRICE. THE TREND OF CANAL ZONE CONTRIBUTIONS TO THE PANAMANIAN ECONOMY CONTINUED TO EDGE DOWNWARD DESPITE

RECENT WAGE INCREASES TO PANAMANIAN EMPLOYEES. AGGREGATE DEMAND REMAINED LARGELY UNCHANGED ALTHOUGH DISTORTED SOMEWHAT BY THE EFFECT OF THE 5 PERCENT VALUE ADDED TAX ON SALES, BOTH BEFORE AND SUBSEQUENT TO ITS MARCH 1 EFFECTIVE DATE. TWO BRIGHT SPOTS HAVE BEEN (A) THE INCREASE IN TOURISM, WITH THE NUMBER OF FOREIGN VISITORS TO PANAMA DURING THE FIRST QUARTER UP 20 PERCENT AND THEIR EXPENDITURES UP 30 PERCENT COMPARED TO A YEAR AGO AND (B) A 12 PERCENT INCREASE IN PUBLIC SECTOR REVENUES (SEE PARA 5 BELOW).

3. THE SLUGGISHNESS WHICH CHARACTERIZED THE ECONOMY IN 1976 CONTINUED UNABATED. YEAR 1976, WITH ITS ZERO REAL GROWTH IN GROSS DOMESTIC PRODUCT (GDP), FOLLOWED THE DECLINING GDP GROWTH PATTERN SINCE THE OIL CRISIS OF 1973--WITH THE 1973 GDP GROWTH RATE OF 6.5 PERCENT DROPPING TO 2.6 PERCENT IN 1974 AND TO 0.6 PERCENT IN 1975. IN REAL TERMS THERE WAS ZERO GROWTH IN PER CAPITA GDP IN 1974, MINUS 2.3 PERCENT IN 1975 AND MINUS 2.9 PERCENT IN 1976. DURING 1976, WEAK INTERNAL AND EXTERNAL DEMAND CAUSED MANUFACTURING ACTIVITY TO DECLINE 2 PERCENT, DOMESTIC TRADE 4 PERCENT, AND EXPORTS 18 PERCENT BELOW THEIR 1975 VALUES, WHILE CONSTRUCTION ACTIVITY WAS DOWN ANOTHER 10 PERCENT AS PRIVATE INVESTMENT CONTINUED TO STAGNATE. SALES OF SERVICES TO THE CANAL ZONE DECLINED FOR THE FIRST TIME IN DECADES, AND DROUGHT CONDITIONS CAUSED A 4 PERCENT REDUCTION IN GENERAL AGRICULTURAL OUTPUT. ON POSITIVE SIDE, THE SERVICES SECTOR AND PUBLIC UTILITIES CONTINUED THEIR SECULAR GROWTH, ALTHOUGH AT A REDUCED RATE. THE GENERAL PRICE LEVEL ROSE BY ONLY ABOUT 5 PERCENT.

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4. MEANWHILE, GOP FINANCES HAVE REMAINED IN A DELICATE STATE--NECESSITATING STRONG CONTRACTIONARY FISCAL POLICIES WHICH AGGRAVATE PANAMA'S ECONOMIC MALAISE. THE GOP BORROWED HEAVILY LAST YEAR, MOSTLY IN EXPENSIVE SHORT AND MEDIUM TERM FOREIGN COMMERCIAL CREDIT (NEARLY \$200 MILLION) TO SUSTAIN ITS AMBITIOUS PUBLIC SECTOR INVESTMENT PROGRAM. THE INTENT WAS TO OFFSET THE DEARTH OF PRIVATE SECTOR INVESTMENT AND STIMULATE ITS RESUMPTION BY SUPPORTING EMPLOYMENT AND INCOME LEVELS. IT FAILED TO STIMULATE INVESTMENT BUT APPEARS TO HAVE ARRESTED FURTHER ECONOMIC DECLINE. HOWEVER, GOVERNMENT REVENUES FELL SHORT OF EVEN MEETING CURRENT OPERATING NEEDS, AND SOME DIVERSIONS OF BORROWED FUNDS WERE NECESSARY TO COVER CURRENT OUTLAYS. THE SERIOUSNESS OF ITS FINANCIAL SITUATION TOWARD THE CLOSE OF 1976 FORCED THE GOP TO TAKE CORRECTIVE FISCAL MEASURES--IN PARTICULAR, SHARP INCREASES IN UTILITY RATES, IMPOSITION OF A 5 PERCENT VALUE ADDED TAX, AND AN AUSTERITY 1977 EXPENDITURE BUDGET.

5. THESE MEASURES HAVE RELIEVED GOP FINANCIAL PRESSURE SOMEWHAT AS GOVERNMENT REVENUES FOR THE 177 FIRST QUARTER WERE ALMOST 12 PERCENT AHEAD OF A YEAR AGO. WHILE THIS IS ENCOURAGING, THE GOP'S PROJECTED REVENUE INCREASE FROM \$282 MILLION IN 1976 TO \$346 MILLION IN 1977 STILL APPEARS HIGHLY OPTIMISITC, EXPECIALLY SINCE GOP PROJECTIONS ASSUM-ED 3 PERCENT ECONOMIC GROWTH. A CRITICAL ASSIST IS THE NEW \$100 MILLION FOREIGN COMMERCIAL BANK CREDIT, WHICH WAS SIGNED FINALLY IN LATE MAY. THE LOAN WILL PROVIDE THE GOP'S FINANCIAL CONTRIBUTION TO VARIOUS FOREIGN FUNDED INVEST-MENT PROJECTS, PLUS SOME REFINANCING. NEW CURBS ON PUBLIC SECTOR SPENDING HAVE ALSO BEEN IMPOSED UNDER THE CURRENT IMF STANDBY: VIZ, (A) A \$40 MILLION CUTBACK IN 1977 INVESTMENT OUTLAYS; (B) PROHIBITION OF NET ADDITIONAL NATIONAL BANK CREDIT TO THE PUBLIC SECTOR DURING 1977; AND (C) USE OF ANY OF THE MORTGAGE BANK'S \$35. MILLION DEPOSIT OF HOUSING FUNDS WITH THE NATIONAL BANK (UNUSED 1976 EURO-CURRENCY LOAN) LIMITED OFFICIAL USE

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WILL REQUIRE A CORRESPONDING REDUCTION IN NATIONAL BANK NET CREDIT TO THE GOVERNMENT. DESPITE SPENDING CURBS AND INCREASED REVENUES, ADDITIONAL CASH BORROWING NEEDS ALREADY ARE BEING EVIDENCED BY SOME MINISTERIES AND AGENCIES. WITHOUT THE PAST FLEXIBILITY OF NATIONAL BANK CREDIT, THE GOP WILL NEED TO TURN INCREASINGLY TO PRIVATE INTERNATIONAL BANKERS TO SEE IT THROUGH ANOTHER FINANCIALLY TROUBLESOME YEAR, AND, THE IMF REQUIRES THAT ANY NEW BORROWOOMFG BE LONG ETAM, I.E., IN EXCESS OF 10 YEARS. THIS MAY WELL MEAN THAT NOT ALL OF THE GOP FINANCIAL NEEDS CURRENTLY PROGRAMMED FOR THE YEAR WILL BE MET SINCE THE BANKS, ESPECIALLY THOSE IN PANAMA, APPEAR RELUCTANT TO ADVANCE MORE CREDIT TO THE PUBLIC SECTOR.

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INFO OCT-01 ISO-00 SS-15 NSC-05 INR-07 CIAE-00 PM-04

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TO SECSTATE WASHDC 2310  
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6. GOVERNMENT FISCAL CONSTRAINTS PLUS THE CONTINUING STAGNATION OF PRIVATE INVESTMENT WILL PROBABLY FORSTALL ANY GENERAL ECONOMIC EXPANSION THIS YEAR. THE 5 PERCENT VALUE ADDED TAX AND HIGHER UTILITY RATES ARE WEAKENING AGGREGATE DEMAND WHICH IN TURN TENDS TO FURTHER SUPPRESS OUTPUT, EMPLOYMENT, AND INCOME. THE NEW CURBS ON PUBLIC SECTOR INVESTMENT OUTLAYS THIS YEAR--BOTH THE BUDGET CUTS AND THE CREDIT RESTRAINTS-- WILL HAVE DIRECT NEGATIVE EFFECTS ON EMPLOYMENT AND INCOME AND ADD TO THE ALREADY UNCERTAIN INVESTMENT CLIMATE. THEN TOO, THE VARIOUS STIMULANTS TO PRIVATE INVESTMENT ADOPTED AT THE END OF 1976 (REF B) HAVE FAILED SO FAR TO PRODUCE THE DESIRED RESULTS--NOT ALTOGETHER SURPRISING SINCE THEY DO NOT GET AT THE CORE PROBLEM OF A DEARTH OF PROFITABLE INVESTMENT OPPORTUNITIES. "INVEST IN WHAT\*" IS A COMMON RESPONSE BY PRIVATE BANKERS TO THE QUESTION OF WHY THERE IS SO LITTLE PRIVATE INVESTMENT. THEY SAY THAT CREDIT IS NOT SHORT AND TERMS ARE NOT STIFF. NOT EVEN EXISTING CREDIT LINES BY ESTABLISHED BORROWERS ARE BEING DRAWN DOWN.

7. PART OF THE PREDOMINANT WAIT AND SEE ATTITUDE IN THE BUSINESS COMMUNITY INVOLVES UNCERTAINTIES SURROUNDING A NEW CANAL TREATY. IN FACT, AGREEMENT ON EVEN THE OUTLINES OF A NEW TREATY WHICH BUSINESSMEN COULD PERCEIVE AS ASSURING STABLE US-PANAMANIAN RELATIONS AND EFFICIENT OPERATION OF THE LIMITED OFFICIAL USE

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CANAL MAY BE THE CRITICAL PSYCHOLOGICAL ELEMENT FOR TURNING THE ECONOMY UP ANYTIME SOON. BY NO MEANS, HOWEVER, WILL A TREATY BE SUFFICIENT TO CURE THE BULK OF PANAMA'S CURRENT ECONOMIC ILLS. THERE ARE PRELIMINARY INDICATIONS, FOR EXAMPLE, THAT INCREASED REVENUES AND OTHER ANTICIPATED BENEFITS TO PANAMA UNDER A NEW TREATY WILL SUFFER SUBSTANTIAL OFFSETS IN THE INITIAL YEARS AS A RESULT OF TRANSITION COSTS AND OTHER PROBLEMS OF INTEGRATING THE CANAL ZONE INTO PANAMA. (MOST BUSINESSMEN ASSUME THAT PANAMA WILL RECEIVE SUBSTANTIAL, EARLY FINANCIAL BENEFITS FROM A NEW TREATY.) THE BEST HOPE IS THAT AN AGREEMENT WILL IMPROVE THE BUSINESS CLIMATE IN PANAMA BY ELIMINATING SOME CURRENT UNCERTAINTIES, AND STIMULATE PROJECT PLANNING TO CAPITALIZE ON NEW INVESTMENT OPPORTUNITIES OPENED UP BY A NEW TREATY. HOWEVER, IT IS UNLIKELY THAT THE TREATY-MAKING PROCESS WILL HAVE ADVANCED FAR ENOUGH TO AFFECT ECONOMIC ACTIVITY IN 1977 (SEE REF A).  
GONZALEZ

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## Message Attributes

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